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SUBJECT: South Africa: Minerals and Energy Newsletter "THE ASSAY" -
Issue 13, November, 2008

This cable is not for Internet distribution.

¶1. (SBU) Introduction: The purpose of this newsletter, initiated in January 2004, is to highlight minerals and energy developments in South Africa. This includes trade and investment as well as supply. South Africa hosts world-class deposits of gold, diamonds, platinum group metals, chromium, zinc, titanium, vanadium, iron, manganese, antimony, vermiculite, zircon, alumino-silicates, fluorspar and phosphate rock, and is a major exporter of steam coal. South Africa is also a leading producer and exporter of ferroalloys of chromium, vanadium, and manganese. The information contained in the newsletters is based on public sources and does not reflect the views of the United States Government. End introduction.

HOT NEWS

Eskom Postpones Nuclear Reactor Project

¶2. (SBU) State power utility Eskom announced its decision not to proceed with a second nuclear power plant. Department of Public Enterprises Director General Portia Molefe said the SAG remained committed to nuclear power to reduce carbon emissions and insure energy security. Eskom made the decision on December 5, following a number of delays during the year. Eskom said it would not proceed with procurement of the proposed investment in the Nuclear-1 project due to the huge capital investment required. The proposed Nuclear-1 project would have been the country's second pressurized water reactor (PWR) plant, after the first and only Koeberg Power Station in the Western Cape. Eskom has terminated the tender process, which designated two bidders, the EPR Consortium led by Areva of France and the N-Powerment Consortium led by Westinghouse of the USA. It appears that the SAG will now play a greater role in advancing its nuclear power program and is seeking a technology partner, who would assist with developing and financing nuclear projects. It is not clear what effect this decision will have on development of the Pebble Bed Modular Reactor technology.

New Oil Discovery Offshore Angola

¶3. (SBU) Oil has been discovered in deep waters off the Angola coast by Italy's oil and gas major Eni and Angola's state oil company Sonangol. The discovery well Ngoma-1 is located about 350 kilometers offshore Luanda and was drilled in 1,421 meters of water to a total vertical depth of 3,383 meters. The well encountered an oil column of 127 meters in high permeability Miocene sands Eni said in a statement. The statement said pumping tests were positive and confirmed the high mineral potential of Block 15/06. The discovery well is located close to the recently discovered Sangos field. Other exploration wells are to follow to prove up the oil potential and to achieve synergies for the development of the western area of Qand to achieve synergies for the development of the western area of the block, according to Eni. Eni is the operator and holds a 35% stake in the block. Sonangol E.P. is the concessionaire and other stakeholders include France's Total with 15% and Brazil's Petrobras International Braspetro with 5%. Eni said it considers Angola to be a strategic country for its future production growth and signed a memorandum of understanding with Sonangol on broad economic, industrial, and social cooperation in August. Angola's potential oil production is around 2 million barrels per day.

DIAMONDS

Still a Girl's Best Friend?

¶4. (SBU) The downturn of the financial markets has seen a rapid withdrawal of mine development funds, particularly in developing countries such as the DRC, Angola, and Zambia, but also in South Africa where a number of new and expansion projects have been put on hold. De Beers Chairman Nicky Oppenheimer has stated that it is too early to gauge the effect of the economic downturn on gem sales. However, the latest analysis of the polished diamond market by the International Diamond Exchange (IDEX), derived from lower tender prices reported by a number of rough producers including BHP-Billiton, projects lower prices and sales for diamond jewelry in all size and quality categories, with no end to this trend in sight. This will determine what happens in the rough markets supplied by De Beers and its competitors. De Beers has already sold off marginal mines such as Koffiefontein and Cullinan, and is negotiating the sale of its Namaqualand and Tanzania mines, while struggling to bring its Snap Lake (Canada) and Voerspoed (South Africa) mines into production. Miners with operations in South Africa and projects in the DRC and Angola will have to use their locally generated cash flows to fund their African projects as it is unlikely that funding will be available for greenfield developments in the region until stability returns to financial markets. This will impact economic development in the region.

Proposed Boost for Jewelry Sector

¶5. (SBU) SA Diamond and Precious Metals Regulator (SADPMR) CEO Louis Selekane has proposed establishing an Industrial Development Zone (IDZ) near OR Tambo International Airport to encourage local and international investment and skills in the jewelry trade. Selekane says the jewelry industry would operate better in a free trade zone, free from the usual bureaucratic constraints. He pointed to Dubai and India, which have used free trade zones to develop their respective industries. Both Selekane and Jewelry Council of SA CEO Lourens Mar agree that the establishment of an IDZ at OR Tambo airport would bring in more rough diamonds from the rest of Africa and, together with another IDZ at the Rand Refinery (gold and silver) east of Johannesburg, would encourage further development of locally manufactured jewelry.

¶6. (SBU) To further boost the regional jewelry industry, the Gemological Institute of America (GIA) plans to open a laboratory in Gaborone (Botswana) by the end of 2008. The GIA also plans to start educational classes on site in the first quarter of 2009. Botswana was the world's top diamond-producer in value terms in 2007, earning about $3 billion in diamond revenues. It ranked second in volume of diamonds produced at 33.64 million carats. GIA Laboratory and Research Senior VP Tom Moses said that the GIA has hired more than 20 local staff who will be offered scholarships, education and
Q20 local staff who will be offered scholarships, education and
training. He said GIA reports would help add value to the high-quality diamonds being mined and cut in Botswana.

SKILLS

Threat to Recognition of SA Engineers

¶7. (SBU) The SAG is proposing to introduce legislation to regulate "built environment professionals," such as engineers, architects and project managers. The purpose of the legislation is to have a single (government) body to register and control the activities and continuing education of "built" professionals, which would replace the existing statutory body, the Engineering Council of SA (ECSA). It would, presumably, also legislate the activities of member societies such as the SA Institute of Mining and Metallurgy (SAIMM). Government claims that the current system of "peer review" (PR) is

blocking transformation (the process of including previously disadvantaged people in the main-stream economy) of the sector by preventing newly graduated black engineers with little practical experience from being certified by ECSA as Professional Engineers. ECSA maintains that the PR system is there to protect the public and is universally accepted as a prerequisite for international recognition of professional qualifications. ECSA claims the new legislation would allow the minister to exempt companies and individuals from the PR process and would effectively disqualify South African engineers from international accreditation. This would, in turn, lead to prospective engineers moving overseas to get accreditation, to a further loss of skills, and a decline in enrollment at local engineering universities. The SAG maintains that the registration process would be unchanged and that the PR system (without using the words "peer review") would remain intact in the legislation. It says that those opposing the legislation are trying to maintain the status quo and retard transformation. The SAG has since withdrawn the proposed legislation "for further study and consultation".

ENERGY

Sasol Seeks Own Resources for GTL Projects

¶8. (SBU) South African petrochemical producer Sasol and Malaysia's state oil company Petronas have announced a joint venture to undertake oil and gas exploration in offshore Mozambique. Drilling commenced in early October with Sasol Petroleum International (SPI) the operator and holding a 50% share in the JV. Petronas Carigali Mozambique E&P holds 35%, and Mozambique's national oil company, Empresa Nacional De Hidrocarbonetos De Mozambique (ENH), has 15%. Sasol already operates the on-shore Pande and Temane gas fields, has other holdings onshore, and has access to some offshore leases in Mozambique. Petronas has a proven track record of offshore oil and gas developments in conditions similar to those found in Mozambique.

¶9. (SBU) In recent months SPI has acquired assets in Australia, Mozambique, Gabon, and Papua New Guinea. Analysts note a shift in

Sasol's strategic emphasis towards the acquisition of natural gas reserves for its downstream gas-to-liquids (GTL) and coal-to-liquids processing. This could indicate an end to the Sasol-Chevron joint venture, formed in 2000 for the purpose of combining Chevron's access to gas reserves with Sasol's technology to convert stranded gas to liquid fuels. The venture has failed to deliver many opportunities for GTL and Chevron is whittling down its stake in their Nigerian joint venture. Sasol's first commercial GTL plant was developed in partnership with Qatar Petroleum, rather than Chevron. Sasol has a three-year capital expenditure program of $700 million, which probably includes a "war chest" for upstream Qmillion, which probably includes a "war chest" for upstream acquisition for more gas resources for GTL projects in various parts of the world.

Prequalifiers for Eskom's IPP Program

¶10. (SBU) Eskom released the names of the 23 national and international developers that it had unconditionally pre-qualified to produce electricity under the multi-site base-load independent power producer (IPP) program. Eskom Demand-Side Management General Manager Andrew Etzinger confirmed that the bids predominately featured conventional coal technologies. He noted that developers would submit detailed plant design and environment mitigation steps during the next round of the process. There was also one liquefied natural gas plant, a liquefied petroleum plant, one hydro power plant, and one solar plant under consideration. Eskom said it required between 2,100 and 4,500 MW of electricity under the

program, with a minimum individual project capacity of 200 MW. The pre-qualified developers listed include a mix of French, Chinese, Indian, and other companies, but no U.S. firms. Requests for proposals are to be issued at the end of November, final bids will close in May 2009, and deals will be concluded in the first quarter of 2010.

MINING

Outlook Mixed for SA Mining

¶11. (SBU) The SAG has proposed massive investment in electricity supply and in road, rail, port, and pipeline infrastructure to increase mining output capacities. It has also provided a grant of some $450 million over three years to increase the number of dams and water supply systems to mines, including supply to 23 platinum mines on the eastern limb of the platinum-rich Bushveld Complex. National Treasury said in its Medium-Term Budget Policy Statement that the government was injecting $6 billion (at a R/$ exchange rate of 10:1) into Eskom, but the electricity provider needed a total of $34 billion over the next five years, which will have to come from financial markets. This amount might be difficult to raise since Moody's Investors Service downgraded Eskom in August to a Baa2, the second-lowest investment grade. This is likely to impede Eskom's ability to raise capital even though the SAG has said it would guarantee that debt.

¶12. (SBU) South African mineral production in the first eight months of 2008 was down nearly 9% year-on-year and export volumes stagnated because of electricity shortages, mine safety issues, and transportation limitations and inefficiencies. However, export earnings in rand for the period were 33.7% higher than in the same period of 2007, due to then higher commodity prices and a weaker rand. The Treasury said it was optimistic about continued strong mineral demand from Asia because growth had been less affected in the Far East than in Europe and North America. However, there were some negative issues confronting the South African economy, which included financial volatility, exchange rate turbulence, and the uncertain economic and political situation.

Gold Production "in Crisis"

¶13. (SBU) Gold production is "in crisis" and a gold price of $900 -$1,000 per ounce is needed to arrest the downward trend, according to AngloGold Ashanti CEO Mark Cutifani. (Note: the gold price was $820 on December 12. End Note.) Cutifani said the world has seen a global decline in gold production over the past seven years and this could continue at up to 5% a year for the next five years. South African production had declined 20-30% in the last five years, and grades were continuing to diminish in opencast mines around the world. However, declining production would result in gold's fundamentals improving, he said. The industry was not investing enough in future production and there were also increasing cost
Qenough in future production and there were also increasing cost
pressures on those with deeper operations and increasing strip ratios. Production has also been set back by the current financial crisis.

¶14. (SBU) The price of gold in the last month or two had done better than all of the other commodities Cutifani said, but expansionary investment in production was much less than for other minerals. He said the quarter ending September had seen gold trading in a range from $988 to $736 per ounce and had subsequently even dipped below $700 per ounce. However, the rand weakening to as much as R11 to the dollar had seen South African mines receiving record rand prices for their product. For the same quarter, AngloGold Ashanti produced 1.265 million ounces (up 1%) and 346,000 pounds of uranium (up 7%)

at a total cash cost of $486 per ounce of gold, which was one of the lowest in the industry and is projected to decrease to $460 per ounce in the fourth quarter. Cutifani said South African operations continued to perform steadily, using 92.4% of historic power supply, while operating at 100% capacity.

Titanium Mining in the "National Interest"

¶15. (SBU) The Eastern Cape Xolobeni titanium sand project was given a mining license by Minister of Minerals and Energy Buyelwa Sonjica in September after easing aside comments by the Department of Environment and Tourism (DEAT) in favor of "the national interest". Titanium has been identified by the SAG as a strategic commodity that will be the basis of a new industrial sector for South Africa: mining to metal and manufacturing. The initial license covers the Kwanyana block, which contains some 139-million tons of titanium-bearing minerals and represents about 30% of the original area applied for. The remaining areas will be held under a prospecting right, valid until 2010 and extendable until converted to mining rights. However, the Department of Minerals and Energy (DME) has stated that it is not yet possible to determine whether further licenses will be granted, as the areas are still under consideration for environmental concerns about developments in the sand dune zones.

¶16. (SBU) The Xolobeni project will be a dry mining operation and its annual production is expected to yield some 250,000 tons of ilmenite, 19,000 tons of rutile, 15,000 tons of leucoxene (all titanium-containing minerals), and 15,000 tons of zircon over an expected life of about 22 years. The project will cost an estimated $200 million to implement and will include access roads to the site and mining area, water supply and pipelines, power reticulation and power supply to the area, a wet separation plant, a tailings storage facility, and a dry minerals separation plant. The mining operation will be located 30 km south of Port Edward in the Eastern Cape and the smelter near Mbizana, some 40 km north of the mining site. (Comment. The anti-mining lobby has submitted another appeal against mining the dunes, which may further delay the project. The fact that the operation will generate some 400 jobs and pump millions of dollars into the region, which is one of the poorest in the country, has failed to impress the lobby. Information confirming whether mining is, in fact, taking place currently and whether the environmental management plan has been approved is not

available. End Comment.)

Further Ferro-Chromium Production Cuts

¶17. (SBU) The joint venture between the world's leading ferro-chrome producer Xstrata Alloys and Merafe Resources announced on December 1 that it had suspended production at another five ferrochromium Qthat it had suspended production at another five ferrochromium furnaces. This represents a cut of approximately 406,000 tons of annual capacity and follows the shutdown of six furnaces with a capacity of 500,000 tons earlier in November. Total capacity closures will amount to 906,000 tons or 52% of annual operating capacity. Xstrata said the furnaces would remain closed until the market improves, but no lay-offs are planned for permanent employees, enabling a quick return to full capacity when market conditions allow.

Samancor Cuts Manganese Production

¶18. (SBU) The world's largest diversified mining company BHP-Billiton announced on December 2 that due to weak market conditions it was temporarily reducing manganese production at its 60%-owned Samancor operations at Hotazel in the Northern Cape Province; Anglo American owns the other 40%. The cuts in output

will be balanced between GEMCO in Australia and Hotazel and will reduce ore production by 21% (1.5 million tons) in 2009. Samancor's current total annual ore output capacity is 7.0 million tons. The company expects to reduce alloy production at its ferro-manganese plants at TEMCO (Australia) and Metalloys (South Africa) by 170,000 tons from a current output capacity of 725,000 tons. Furnace re-builds will be brought forward at both facilities, and certain furnaces will not be re-started until market conditions improve.

¶19. (SBU) This situation contrasts markedly with that prevailing in the earlier part of the year when record output was achieved from these same mines. BHP increased its manganese production in the quarter ended September 30 to 1,830,000 tons of manganese metal-equivalent, which was a 27% increase over the quarter ended September 2007, despite using 10% less power. Manganese alloy production was also up 10% at 203,000 tons over the 2007 quarter. This was the "payback" on BHP Manganese President Peter Beaven's investment of $100 million to expand the Hotazel mines and to import large diesel generator sets to boost power supply. BHP is also expanding its cogeneration manganese alloy facility south of Johannesburg. South Africa holds some 80% of the world's manganese resources and is the second biggest producer and exporter of ferro-manganese metal and manganese ore. Beavan said he expected volatility and uncertainty to continue in the short term, but was confident that ongoing industrialization and urbanization of China would continue to drive longer-term demand for manganese.

BHP Billiton's $1.4 billion Coal Investments

¶20. (SBU) BHP-Billiton is developing two steam-coal mining projects in South Africa with a combined value of $1.4 billion for production in 2009 and 2010. These are the $450 million Klipspruit project, which is more than 50% completed, and the larger $975 million Douglas-Middleburg project. BHP South African CEO Marius Kloppers said that Klipspruit would ramp up to 3.9 million tons of coal per year, made up of 1.8 million tons for export and 2.1 million tons for domestic power generation by power utility Eskom. The Douglas-Middelburg Optimization project would ultimately produce 18.5 million tons a year, of which 10 million tons would be for export and 8.5 million tons for the local power-generation market. BHP already supplies coal to three Eskom power stations in Mpumalanga province.

Zambian Copper under Threat

¶21. (SBU) The current financial crisis will adversely affect demand for Zambian copper and hurt the flow of foreign direct investment, the Zambian Central Bank has warned. Zambia Financial Markets Director Richard Chembe addressed a workshop in Zambia and said a prolonged financial crisis would affect demand for copper among Qprolonged financial crisis would affect demand for copper among major consumers like China and lead to a stagnation of growth in the copper mining industry and a reduction in the country's foreign direct investment and exchange earnings. The Zambia Chamber of Mines also painted a bleak outlook for the Zambian mining industry during and after the current financial problems. Chamber President Nathan Chishimba said the majority of mining companies relied heavily on foreign capital to provide the bulk of capital for exploration, pre-development operations, and overall mine development. Mid-tier exploration companies funded more than half of the ongoing exploration. Chishimba said the GRZ was watching developments with a view to quick intervention to save the economy and particularly the mining sector should the knock-on effects of the financial crisis lead to a slump in long-term investment in the mining industry.

BOST